

# **PUBLIC-PRIVATE PARTNERSHIPS: WHAT WORKS? WHAT DOESN'T? WHAT'S NEXT?**

## **Lessons From The Military Housing Privatization Initiative 1996-2016**

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*[Following Introduction by Andrew Philip Hunter]*

Thank you for the introduction.



*Fort Belvoir Town Center*

From the private-partner's perspective, I'll summarize how we innovate, some of our lessons-learned, as well as the business case for public-private partnerships. If you haven't been to the installation, we saw an opportunity right in the heart of the post not just to replace housing but to use the Town Center at Fort Belvoir as an example of "placemaking". If we were going to build housing outside the gate, we would think about how to integrate it into a mixed-use community of residential, retail and office space.

That's exactly what we did here with ground-floor retail, the leasing center, office space on the first floor, and families living above. It was not an easy case to make because AAFES (the Army and Air Force Exchange Service) had its own approach to development, and we had to figure out a way to build a partnership among the Army, AAFES, and ourselves to convince everyone that this was the right thing to do. It's been a case study as to how that can be done.



*Wounded Warrior Project home*

The second example to feature the "how" of innovation is the Wounded Warrior Homes at Fort Belvoir. As part of the RCI privatization effort, we were rebuilding not only townhomes and single-family homes, but also accessible homes. Up to about 5% of our portfolio was accessible and our guideline was to build to essentially the ADA (Americans with Disabilities Act) requirements. Normally, we follow the UFAS (Uniform Federal Accessibility Standards) code for housing and design to the code minimum. But we recognized midway through the project was that the UFAS standards were not meeting the needs of our soldiers and families. Families of Service

Members who were returning with issues such as PTSD and TBI were not addressed in the UFAS code. So we concluded – without the Army's direction – to re-look at accessibility, and instead of designing to a code minimum, tried to design to the true needs of the families. Because of the flexibility of the partnership agreements, we were able to hire the late world-renowned architect Michael Graves, who himself had become wheelchair-bound in his 60s, and develop specialized housing with numerous exterior and interior features: for example, zero-threshold entrances to the house from multiple access points; a 12-zone HVAC system; countertops that move vertically to meet the residents' needs; roll-in showers with French drains and aesthetic grab bars. The homes are adaptable and we have already proved that any family would want to live in them.



Next, I'll touch on the development and management process. In addition to taking care of families with the new homes, we looked at how to enhance the community experience. The property manager is an example of innovation in our Navy project in San Diego. Pacific Beacon has over 2,000 single

sailors living there. This project is a hybrid between an apartment building, a hotel because of short-term stays, and a resort. We recognized that the MWR functions on the Navy base were essential, but for high resident satisfaction to attract and retain sailors, we needed to amp up those facilities and programs. We have not just one or two events there a year but multiple events *per month*, from small events, such as cooking classes and Monday Night Football, to large events such as New Years and Halloween parties. Their scope and variety show how the private partner thinks about the residents' true needs and creatively, responsively enhances MWR programs to improve the quality of life experience -- the mission we all rally behind.

Another innovation that RCI introduced into the military housing development process is the "pilot neighborhood". Before we embarked on large-scale renovations, we knew that we were making \$30 to \$50 million dollar investments per neighborhood. We saw the opportunity to build one or two pilots first, for two primary reasons.

First, we wanted to work out the details. if you've ever renovated your own home, you've learned that you never know for sure what's behind the walls until you've removed the drywall, opened them up, and possibly discover surprises that you didn't think you would see there. On a much larger scale, we do the same to zero in on our construction costs and work out many details before embarking on a large-scale construction phase.

Our second reason for the pilots which proved especially valuable was to quickly move residents into their homes. As soon as a neighborhood was completed and occupied, we surveyed as many new residents as possible about which aspects of their home and community they liked (i.e. kitchen layout, appliances, etc.) and don't like. I like to think that every neighborhood we've done is distinctive and different. We don't simply take

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Indianhead Pilot Renovation								
#	Neighborhood	Unit Type	Item	Comments	Reason	Number of Items Referenced	Action to be Taken	Action Taken
1	Indianhead	U3	Interior	New showerhead manufactured.		2		
2	Indianhead	U3	Interior	Bathrooms are small, small tub.		1		
3	Indianhead	U3	Interior	Leave the big opening instead of two small openings to kitchen.		1		
4	Indianhead	U3	Exterior	Not not installed properly.		1		
5	Indianhead	U3	Exterior	The fence is a perfect addition.		1		
6	Indianhead	U3	Interior	The back wall is larger.		1		
7	Indianhead	U3	Interior	I prefer lots of counter space.		1		
8	Indianhead	U3	Interior	Should like exterior painted.		1		
9	Indianhead	U3	Exterior	Not enough plants or bushes.		1		
10	Indianhead	U3	Interior	Should be washer/dryer included with unit.		1		
11	Indianhead	U3	Interior	Likes the U3 bathroom plans over U3 cabinet layout.		1		
12	Indianhead	U3	Exterior	The back yard is not as big as what the currently have.		1		
13	Indianhead	U3	Interior	Master bedroom is smaller than where they currently live.		1		
14	Indianhead	U3	Interior	New windows are much more looking from the inside windows of U3.		1		
15	Indianhead	U3	Exterior	Protect the wooden fence over chain link.		1		
16	Indianhead	U4	Interior	Leave the big open kitchen.		2		
17	Indianhead	U4	Interior	Does not like the small master bedroom.		1		
18	Indianhead	U4	Interior	Likes the open shower stall dipping more than shower/bath combo.		1		
19	Indianhead	U4	Exterior	Not not installed properly.		1		
20	Indianhead	U4	Exterior	Loves the new concrete patio.		1		
21	Indianhead	U4	Interior	Does not like the metal windows.		1		
22	Indianhead	U4	Interior	Should probably choose the U3 plan.		2		
23	Indianhead	U4	Interior	Wishes the half-bath + Master was better.		1		
24	Indianhead	U4	Interior	Should have space above refrigerator should be cabinet storage.		1		
25	Indianhead	U4	Interior	Too few cabinets.		1		
26	Indianhead	U4	Interior	Likes that there is more counter top space.		1		
27	Indianhead	U4	Interior	The closest doors are too small.		1		
28	Indianhead	U4	Interior	The bathroom are too small.		1		
29	Indianhead	U4	Interior	Cabinets/interior jacks should be on both parallel walls.		1		
30	Indianhead	U4	Interior	Does the laundry closet in the kitchen.		1		
31	Indianhead	U4	Interior	Wishes the new doors instead of repainting the old.		2		
32	Indianhead	U4	Interior	No new closets.		1		
33	Indianhead	U4	Interior	Would like washer/dryer included with unit.		1		
34	Indianhead	U4	Interior	Wishing patio door and main doors would be open.		1		
35	Indianhead	U4	Interior	Consider raising the stove vent to allow steam to escape.		1		
36	Indianhead	U4	Interior	Want doors closed excepting plans to open.		1		
37	Indianhead	U4	Interior	Loves the new lights and the new trim.		1		
38	Indianhead	U4	Interior	After storage for the kitchen of U4.		1		
39	Indianhead	U4	Interior	Likes that there is more light produced by the new light fixtures.		1		

In later phases of the project, we had more open floor plans. If you're buying a new house today, you probably want your kitchen to spill into your living room, reflecting how modern families are living. After the pilot and survey research, we knew we were right on point on these and many other details and completed the investment case.

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for which disability needs each feature addresses. We would take all that information, price every option out, sort it to figure out what we could afford to do, and then make the trade offs. We still have that information and continue to monitor these resident surveys for what people like, what works and what doesn't.

Turning to design, Sandy cited design as a tool to help foster a sense of community, and "New Urbanism" as a set of urban planning principles and practices adopted by RCI projects. General Keane also highlighted Columbia, Maryland, as one of the models for Army leaders in establishing RCI. New Urbanism designs generally are more dense than traditional tract housing developments. Some people think that density -- more homes per acre -- would reduce a community's attractiveness. But in our military communities, you'll find families gathering on village greens, and people getting to know their neighbors on front porches that are close together because we put the garages at the rear or side of the house.

## Army Living Unit Density Guidelines

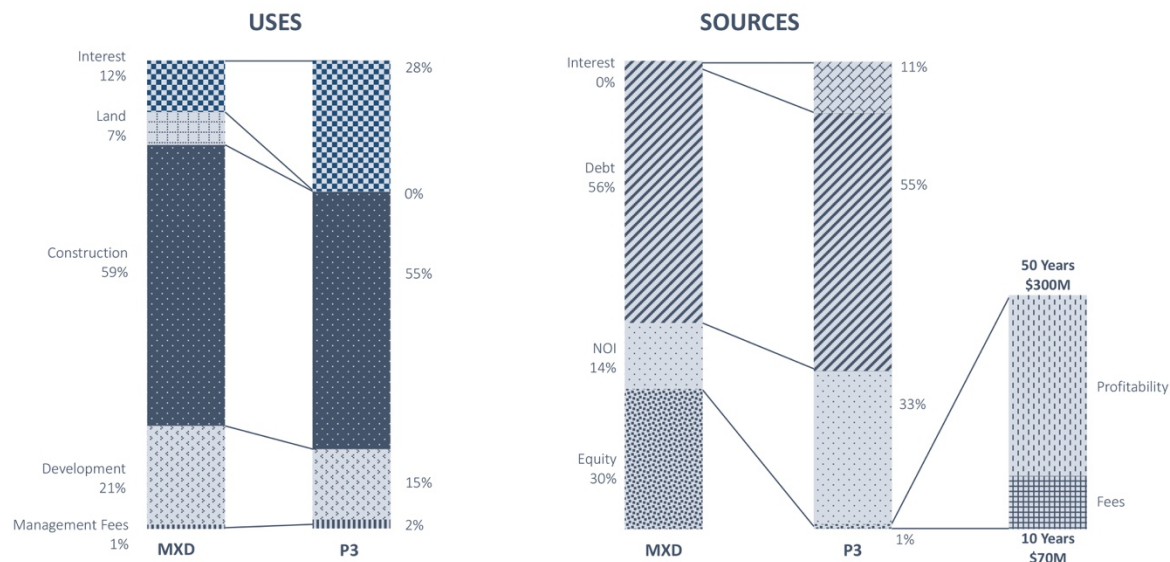
GRADE	LOW DENSITY [UNITS/ACRE]	MEDIUM DENSITY [UNITS/ACRE]	HIGH DENSITY NEW URBANIST RANGE [UNITS/ACRE]
SSG & Below	4 – 7	8 – 10	11 – 15
SFC – SGM	3 – 5	6 – 9	10 – 12
LT – CPT	3 – 5	6 – 9	10 – 12
MAJ – LTC	2.5 – 3	4 – 5	6 – 9
COL	2	3	4 – 6
BG & Above	1	2	3 – 4

Source: RCI Standards, 2003

This simple design principle of "managed density" helped to achieve the mission of improving the quality of life by fostering a sense of community. With high Service Member turnover on these posts, we wanted to create opportunities for them and their families to get to know each other as quickly as possible. And from a land perspective, we actually preserved real estate. While these military installations are large, their land available for development is limited, so if you can fit more homes within a smaller footprint, it saves land for other mission purposes down the line.

Lastly, I'll highlight the economics of RCI and the business model from the private partners' perspective. This slide summarizes the *Sources* of funds for each project, and the *Uses*, or how the funds are spent.

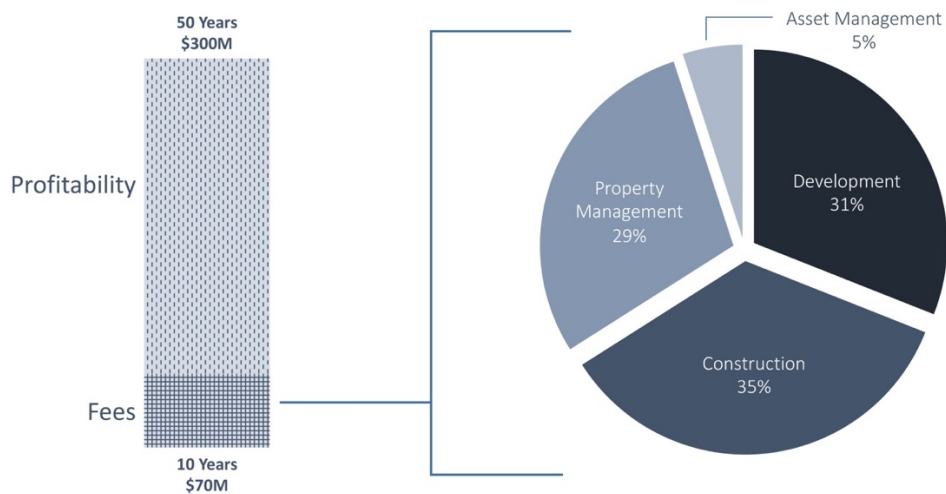
## Representative Sources and Uses Comparison



We've compared the Sources and Uses in a typical military P3 project with a typical market-rate mixed-use development (MXD) to highlight the primary differences between them. On the Sources side, the P3 model leverages the military's land. The developer is not paying for military land as we would for commercial land in Washington, DC or any other market. The military is actually contributing its land to a public-private partnership at no cost. So, the dollars that we would have spent on land can be spent on the mission -- to build and renovate houses in the military communities. On the Uses side, the interest cost is higher in a P3 because of the long-term financing we raise. A typical project with a construction loan has refinancing risk: to build an office building, the developer has to refinance it over and over again in the market. In RCI, we raised 40-year bond financing, which removed the refinancing risk. The interest rate is a bit higher, but the numbers work.

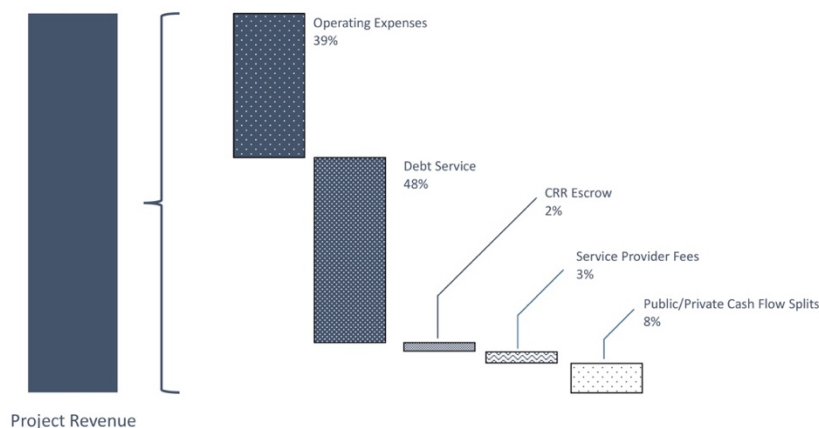
The main Source of funds is the third party debt (40-year bond financing, as mentioned above) that supports this mission. We also have Interest Earnings on that debt over time when it's kept in the bank account. Net Operating Income -- from the Basic Allowance for Housing that soldiers receive and pay out to us as rent -- flows in from Day One when we take responsibility for the project and helps to fuel the development. The biggest difference between the P3 model and a private mixed-use development is the amount of equity that's required. In today's financial market, a \$300 million project might need up \$100 million of equity, or one-third of the total capitalization. In the RCI P3 model, the equity required is only 1 to 2% of total capital. So the equity in RCI P3 projects is highly leveraged -- the developer still has "skin in the game" and dollars at risk, but instead of having to pay the equity investors a return on their equity, the dollars are being leveraged to plow back into the project.

## Representative Sources and Uses Fee Breakdown



The private developer's business case -- How do we make money? How do we stay in business? -- provides for a return on equity that typically is capped. But the developer's primary profits are the fees to perform services throughout the long-term development process. These include a base fee and an incentive fee with metrics that our military partner determines, which are split between construction, development, property management, and asset management. I want to highlight asset management because this shows that the partner is in the project for the long term: it's not just to build the houses, sell and leave; it's a 50-year partnership or a long-term marriage. As the asset manager, you're always asking "when should those roofs be replaced, when should the kitchen be redone, what is the plan to maintain occupancy and sustain a viable business model?" Market rate fees negotiated up front also have caps.

## Representative P3 Project Waterfall



The last slide is what we call the "waterfall" to show how dollars come into the project and how they are spent. The Soldiers who rent our houses pay in their Basic Allowance

for Housing. We then pay our expenses -- cutting the grass, utilities, work orders, and all the normal tasks of property management -- to make sure the houses stay fit. Next, we have to pay debt service -- that's the principal, interest and fees on our development loans. Finally, the chart shows the capital repair and replacement, so when the HVAC system breaks, as it eventually will, the funds are available to replace it -- one of the key advantages of RCI over traditional Military Construction (MilCon) funding. The cash flow designated for the RCI partner is generally capped: most of it stays in a reinvestment account, and we are the fiduciary so we're always thinking about how are those protected dollars are going to be spent over time. This is all about the long-term, or sustainment. As an example, in the Fort Belvoir project, we anticipate over a billion dollars going into the capital repair and reinvestment accounts so that we can project out what we need and not find ourselves in the pre-privatization situation, with all of the deferred maintenance and repairs still to be funded from annual DoD budgets and Congressional appropriations.